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California Outlook: Agriculture 1984

May 22, 1984

OVERVIEW

Total income for California farmers will improve in 1984. Gross farm income is expected to be up 4.9 percent from 1983, reaching $16 billion. The increase will be largely the result of increased acreage and production of grains and cotton. Despite the expected improvement in gross income, however, many farmers will face continued financial problems of high debt levels and declining farmland values. Heavily indebted growers will have difficulty generating a positive cash flow. Survival, not expansion, will be the concern of most farming operations.

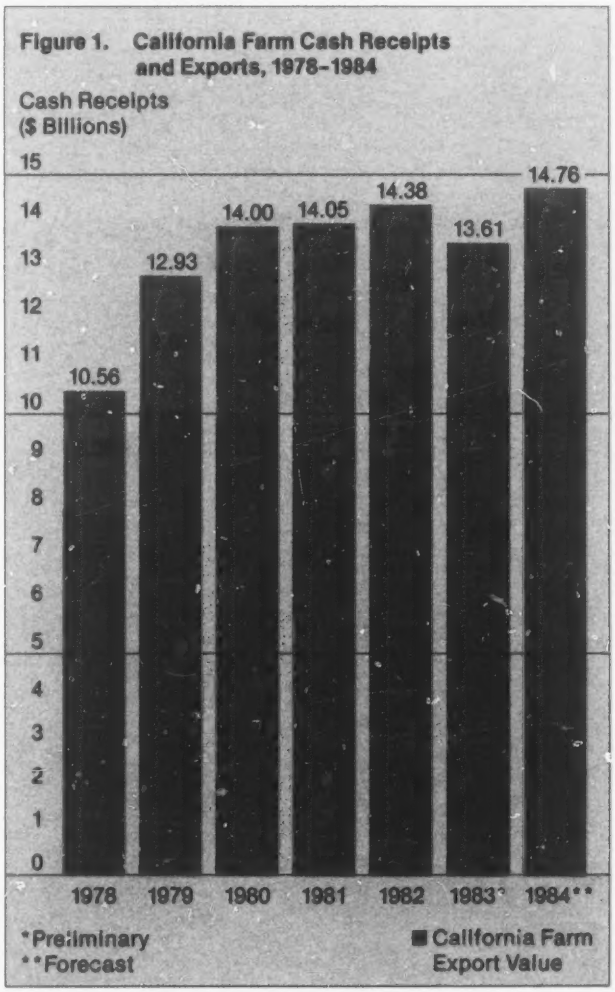
Net farm income is expected to improve in 1984 to $3.8 billion, up 6.8 percent, the largest percentage increase since 1979. Even with increased acreage of grains and cotton, total production expenses will be up only 4.3 percent reflecting a relatively low inflation of farm input prices.

Federal government agricultural programs will, to a large extent, be curtailed in 1984. Last year's Payment-in-Kind (PIK) program, in combination with the Midwestern drought, reduced stocks of major grains and cotton. With lower stocks and higher prices going into the new crop year, government programs will be less attractive to growers. In addition, pressures from Congress to cut farm-support expenditures following the expensive 1983 programs have forced a cutback by the Department of Agriculture on incentives to growers to participate in the 1984 support programs. Dairy support is also being reduced through the Dairy Adjustment Act.

Consumer food prices will increase a modest 6 percent in 1984. Following double-digit increases in the late 1970s, retail food price inflation declined in the 1980s to bottom out at 3 percent last year. Increases in prices this year can be attributed, almost exclusively, to higher meat prices. Beef and pork prices will be up because of lower supplies resulting from last year's high slaughter rates. Egg prices have also increased due to Avian Influenza which significantly reduced flocks.

The value of exports of California farm products is expected to increase in 1984 for the first time since 1981. Although exports as a percentage of cash farm receipts will increase in 1984, the more than $4-billion-dollar level of exports recorded in 1981 will not be reached (see Figure 1). Economic recovery will boost demand for farm products, but the strength of the dollar relative to foreign currencies and high third-world debt will limit sales to foreign buyers.

Figure 1. California Farm Cash Receipts and Exports, 1978–1984



EXTERNAL FACTORS

During 1984 the performance of California's agribusiness sector will continue to be heavily influenced by forces beyond the control of farm managers. World economic growth is expanding the demand for food products. If the generally good growing conditions experienced thus far this year continue, increased supplies of the state's farm products will be available. The ability of California farm products to reach world markets will, however, be limited by a continued overvalued dollar and trade friction with the European Economic Community and Japan.

Help from Improved Economy

Personal incomes in the United States are forecast to increase 6 percent in 1984, resulting in greater spending on both durable and nondurable items. Purchases of specialty food products, especially wine, fruits, nuts, and vegetables produced in California, are expected to increase significantly. Increased spending on durable items also will give a boost to California agriculture. The revival of housing sales has increased sales of furniture, carpets, and draperies. With textile demand strong, cotton sales also have increased, boosting demand for the state's number two crop.

World economic growth also will expand the market for food and fiber in 1984. This growth will not keep pace, however, with the economic expansion occurring in the United States. In fact, economic growth in the United States and Canada will be the major factor driving increased output in Europe and Asia. Expanding export sales to the United States and Canada have up to now accounted for the major expansion in markets for European and Asian goods.

The strength of the dollar relative to other currencies has helped Western European and Asian countries to expand their U.S. sales. In Europe, consumer confidence is starting to improve, which will lead to greater expansion of output later this year. Japan's economy will also gain strength throughout 1984. Latin American economies should strengthen, but in order to service their large debts these countries will attempt to limit imports and expand exports. Overall, exports, which account for 25 percent of California's farm commodity sales, will see some gain from an expanding world economy in 1984.

Strong Dollar Inhibits Exports

California farm exports have been severely curtailed in the 1980s by an unprecedented strengthening of the dollar relative to other currencies. Since 1980, 32 percent more West German marks are needed to buy one U.S. dollar. Similarly the number of Japanese yen required has increased by 17 percent, the number of French francs by 72 percent, and the number of Italian lire by 67 percent. Thus, consumers in Germany would now be paying 32 percent more for a California farm product that has not changed price since 1980.

In addition, the currency fluctuation has allowed foreign farm commodities to outperform California commodities in the U.S. market. An Italian wine producer who sold a bottle of wine in New York for $3 per bottle in 1980 now can sell the same bottle for only $1.80 to realize the same number of lire as received in 1980.

The dollar has strengthened because real interest rates (interest minus inflation) in the United States are higher than in other countries. This, coupled with economic and political instability in many countries, has induced foreigners to exchange their currencies for dollars. Clearly, the current high value of the U.S. dollar is sustainable only as long as foreigners are willing to move new funds into the United States. It is, however, difficult to forecast with any precision when this growing demand for U.S. dollars will ease and the value of the dollar will decline.

During recent months there has been some decrease in the demand for dollars. In part, this is due to foreigners adopting a wait-and-see attitude toward the dollar in anticipation of the U.S. presidential election. A more substantial decline in the strength of the dollar must wait until the real interest rate declines and world economies strengthen.

COMMODITY OUTLOOK

Field Crop Acreage to Expand

The outlook for California's field crop farmers is greatly improved from one year ago because of lower inventories of grains and cotton. Excessive domestic and worldwide stocks of field crops—which accumulated in the early 1980s—were dramatically reduced by the Payment-in-Kind (PIK) program and last year's Midwestern drought. As stocks have gone down, most prices have increased. Cotton and corn prices averaged as much as 40 percent above year-earlier levels during the first quarter of 1984. The outlook for crop prices for 1984 and beyond has also improved with the stock reductions.

Optimism must be tempered, however, by the potential for a return to overproduction in 1984. In the absence of attractive government programs to reduce acreage, California and other U.S. growers are likely to return to the production levels of the early 1980s, creating the potential for stocks of commodities to increase which could cause prices to fall.

Government acreage reduction programs, except for

Table 1. California Farm Income and Expenses, 1978-1984

Year	Cash Receipts	Percent Change	Gross Farm Income	Percent Change	Production Expenses	Percent Change	Net Farm Income	Percent Change
	(millions)		(millions)		(millions)		(millions)	
1978	$10,575	12.0	$11,078	11.7	$ 8,142	7.4	$2,936	25.8
1979	12,932	22.3	13,559	22.4	9,712	19.3	3,847	12.2
1980	14,002	8.3	14,688	8.3	10,956	12.8	4,092	6.4
1981	14,048	0.3	14,876	1.3	11,374	3.8	3,502	-14.4
1982	14,379	2.4	15,364	3.3	11,979	5.3	3,384	-3.4
1983	13,607	-5.4	15,257	-0.7	11,700	-2.3	3,557	5.1
1984	14,760	8.5	16,000	4.9	12,200	4.3	3,800	6.8

Bank of America estimates for 1983 and forecasts for 1984.

THE DAIRY ADJUSTMENT ACT

California's dairy farmers will be paid to reduce milk sales in 1984 for the first time in the history of the dairy price-support program. These payments, funded by both dairy farmers and the federal government, are part of the Dairy and Tobacco Adjustment Act of 1983 passed by Congress last December. Pressures for such a program mounted when Department of Agriculture purchases of dairy products reached an equivalent of 16.6 billion pounds of milk in 1983 for a cost to taxpayers of $2.5 billion.

The program affects California dairies, producers of the state's number-one agricultural commodity, in the following ways:

- Pays dairy farmers who participate in the program $10 for every 100 pound reduction in milk marketings, amounting to 5 to 30 percent of their 1982 or average 1981-82 marketings.
- Reduces the federal dairy support price available to all producers by 50 cents to $12.60 per hundredweight (cwt) of milk. The law allows for additional support price cuts of up to $1 in 1985.
- Imposes one mandatory 50-cent per cwt assessment on milk marketings and eliminates the Agriculture secretary's authority to impose two 50-cent per cwt assessments. The money collected will help finance the $10 per cwt milk diversion payments made to dairy farmers.
- Establishes a national dairy promotion and research program to boost dairy product consumption. The program is funded from deductions of up to 15 cents per cwt on dairy producers' milk marketings.

Ideally the program would reduce output by inducing dairy farmers to slaughter portions of their herds. Reduced output would allow fewer government purchases and lower stocks of dairy products. This situation would allow the supply of milk to more closely match demand. Consumers would benefit by finding lower prices for milk and other dairy products.

While the outcome of the program cannot yet be fully determined, the results appear to be mixed thus far. Sign-ups for the reduction payments have been disappointing. One million dairy cows originally were expected to be slaughtered as a result of the program, but current estimates for the slaughter are only one-third that amount. There are three reasons for the low participation in the program:

- Those dairies that have expanded since the 1982 base period could not benefit significantly from the program.
- Many dairies have heifers about to come into production that they do not want to slaughter since these animals are likely to be the most productive animals in the future. These dairies did not want to enlist in the program and risk a decline in the long-run productivity of their operations.
- The dairy program is complex and confusing. Many dairies did not enroll simply because they did not fully understand the program.

With only limited participation, the Dairy Adjustment Act is not likely to significantly reduce the milk surpluses that have developed throughout the United States. Government expenses for the dairy program will remain high and stocks of milk products large. The program will help lower prices to consumers, however. In addition, milk consumption should be stimulated by the "baby boomlet" now occurring in the United States. Nevertheless, the 1985 farm bill will need to take further steps to reduce the dairy product surpluses and return balance to the dairy industry in both California and the nation. California dairies should prepare for a 1985 government program that increases limitations on output and lowers price supports.

wheat, have been largely curtailed in 1984, opening up the possibility of extensive acreage being planted. Given normal weather patterns, large crops can be expected. For inventories of field crops to remain at reasonable levels, sales must improve. Expanded sales will depend on the world economic recovery and the value of the dollar relative to other currencies. Up to 80 percent of some California field crops have been exported in previous years.

Cotton

California cotton growers can be expected to expand their acreage by 50 percent in 1984 over 1983 levels, giving a healthy boost to the state's cotton production. A record crop is possible. Prices, however, are likely to be below 1983 levels when a shortage of the state's high quality Acala cotton gave the state's growers a premium price for their crop. Without this premium and without PIK receipts, cotton will return to being a break-even proposition for many growers. In addition, those producers who increased debt in the 1970s and now have large interest payments are likely to have negative cash flow.

In the longer term, expanding domestic and Asian markets for California cotton are encouraging. With economic expansion in the United States, sales of textiles have been strong and cotton has been obtaining an increasing share of these markets. The retail market share for cotton rose 3 percent from 1980 to 1983, reaching 39 percent of the domestic market for textiles.

Especially robust demand for textiles from the nonapparel markets has occurred with the expansion of home building in the United States. Sales of carpets, furniture, draperies, and other products related to home buying have been strong. Both domestic and Asian mills have benefited from increasing textile demand in the United States and have increased purchases of California cotton.

Rice

Rice producers have been excluded from the price-boosting impact of the 1983 PIK program. Despite a drop in U.S. production of 35 percent in 1983 from 1982 levels and a 45 percent drop in U.S. rice stocks, rice prices have remained low.

Low prices are attributable to abundant crops in most of the major rice-producing countries. Most world rice production is consumed in the country where it is produced, with only about 3 percent available for export. California is an important supplier of rice to Asian markets, and the state's rice producers are dependent on these markets to sell their product. In years of good crops, import needs are reduced. The market can be extremely volatile, however, since a production shortfall in even one key country, such as occurred in 1980 and 1981, sends prices climbing.

In an effort to stabilize their industry, California rice growers are increasing production of long-grain rice. Historically, California has produced medium-grain rice, which is popular in Asian markets. Long-grain rice has been grown in the Mississippi Delta states and Texas for the domestic and European markets. California growers are interested in increasing production of long-grain rice because of its higher prices and more stable markets. However, current yields on long-grain rice grown in California are low compared to medium-grain rice, which offsets the higher prices. Research advancements are being made with new varieties of long-grain rice at University of California, Davis, which are expected to increase yields. Once new varieties are found, more acreage of long-grain rice should improve the long-term profitability and stability of the California rice industry.

Livestock Margins to Improve

Some relief from the increasing costs and competition that plague California's livestock industry will occur in 1984. While benefiting field crop producers, the 1983 PIK program increased feed costs to the state's beef and poultry producers. Larger feed crops in 1984 will lower costs. In addition, price improvements for meat, resulting from decreased output, will allow livestock and livestock-product cash receipts to reach a record of nearly $4.5 billion, up 4 percent from the 1983 level.

Beef

Beef producers will see gradually improving margins in 1984 as beef prices increase and feed costs decline. Feed price escalation during 1983 forced beef producers throughout the United States to liquidate portions of their herds. In the short run, this action lowered beef prices because of excessive supplies.

It was expected that by early 1984 prices for beef would be improved because the earlier slaughter would lower herd size and beef-production capacity. However, the Dairy Adjustment Act, announced in December, was expected to induce slaughter of one million dairy cows, further depressing beef prices. Due to poor enrollment in the dairy program and lower than expected dairy-cow slaughter, however, beef prices have strengthened. Prices should continue to improve as the economic recovery boosts meat demand. Margins for producers will also get a boost in October when harvest of a large U.S. corn crop should lower feed costs.

Although the short-term outlook shows improvement for California beef producers, long-run difficulties will continue to plague the industry. Consumers are increasingly switching to poultry and fish. Between 1965 and 1984 per capita poultry consumption increased more than 50 percent, fish more than 20 percent, while per capita beef consumption remained flat. In addition to competition from other products, California producers face increasing competition from other states.

Because California does not produce enough feed to meet its needs, the boost in energy prices in the 1970s greatly increased feed cost in the state because of higher transportation costs. As the economics of feeding cattle in California deteriorated, the number of feed lots and packing houses in the state has declined. This has forced some calves and fed cattle to be shipped outside the state for feeding and slaughter, reducing net prices to producers as a result of increased transportation costs.

Eggs

The outlook for egg prices and producer margins in 1984 is the best in years. Reduced hen numbers throughout the United States have boosted farm level egg prices nearly 50 percent above year earlier levels. Prices should stay strong throughout 1984 since production will remain low. In addition, feed prices during the fall are expected to drop when a large U.S. harvest of corn and soybeans is expected.

Production of eggs is down due to hen loss during 1983 and 1984. When feed costs skyrocketed last year due to the PIK program, margins for egg producers narrowed, forcing producers to reduce flocks. In addition, last year's Midwest drought and hot weather, followed by an extremely cold winter, added to feed costs and contributed to a high death rate among Midwestern flocks.

Avian Influenza required 4.9 million layers to be destroyed in the East and Midwest, further reducing production. California producers were hit by high feed costs, but were spared the damage from extreme temperatures and, thus far, from Avian Influenza. This has allowed the state's egg producers to receive good margins without suffering from the setbacks their Midwestern and Southern competitors have faced.

Egg producers, however, do face long-run competitive difficulties similar to the state's cattle producers. Per capita consumption of eggs is declining because of cholesterol concerns by the public and reduced breakfast consumption. In addition, California egg producers face stiff competition from other states. California egg-production costs are higher here than in other states because of higher feed, labor, and land prices.

Table 2. Cash Farm Receipts in California, 1978–1984

Year	Vegetables	Percent Change	Fruits and Nuts	Percent Change	Field Crops	Percent Change	Horticultural Specialties*	Percent Change	All Crops	Percent Change
	(millions)		(millions)		(millions)		(millions)		(millions)	
1978	$2,035	7.8	$2,530	20.4	$1,943	5.3	$ 665	11.9	$ 7,173	11.6
1979	2,246	10.4	2,988	18.1	2,666	37.2	805	21.1	8,705	21.4
1980	2,527	12.5	3,059	2.4	3,421	28.3	906	12.5	9,913	13.9
1981	2,837	12.3	2,916	-4.7	3,128	-8.6	940	3.8	9,821	-0.9
1982	2,734	-3.6	3,056	4.8	3,267	4.4	941	0.1	9,998	1.8
1983	2,905	6.3	2,632	-13.9	2,790	-14.6	980	4.1	9,307	-6.9
1984	3,050	5.0	2,900	10.2	3,300	18.3	1,040	6.1	10,2	10.6

*Includes Forest Products.
Bank of America estimates for 1983 and forecasts for 1984.

Vegetable Output To Expand

California's vegetable producers will continue to expand output following record 1983 cash receipts of $2.9 billion. In 1984, cash receipts will again rise, up 5 percent to over $3 billion. Acreage is likely to expand if weather patterns continue to be more normal than last year. Prices, however, are not likely to be as favorable to growers, especially fresh-vegetable producers, as last year.

The unusually heavy spring rains of 1983 upset plantings and marketings of vegetables, allowing for short time periods in the vegetable markets when supplies were short and prices were high. Growers who were able to market their products during these periods profited. In 1984, however, weather patterns appear to be more normal and high-price periods are unlikely. Overall, markets for fresh vegetables should be strong as a result of robust domestic economic growth.

Lettuce

California lettuce farmers continue to expand acreage in 1984 and the unseasonably warm winter will result in good yields. Large production, in addition to increasing competition from other states, is likely to keep lettuce prices low. The market for lettuce, however, is expanding. Consumers are switching to fresh produce and away from processed vegetables. Increased sales of lettuce (the base ingredient for salads) have resulted from this trend.

Annual per capita lettuce consumption in the United States has increased from 23 pounds per person in 1970 to almost 30 pounds per person today. California, the nation's leading lettuce-producing state with 75 percent of U.S. production, has benefited from this trend.

Nevertheless, recent economic changes have altered the long-run competitiveness of California lettuce growers, giving incentives to growers in other states, especially Florida and Texas, to expand production. California growers do have an advantage over those in other areas in term of soils and growing conditions. However, rapidly rising energy and labor costs during the late 1970s decreased the state's comparative advantage in vegetable production.

In the 1960s and early 1970s, when gasoline prices were much lower, California growers could ship their produce to distant markets and still realize higher returns than growers in other vegetable-producing states. However, because of increased transportation rates, reflecting higher fuel prices, growers in Florida, Texas, and New Jersey now can ship their lettuce to East Coast and Midwest markets more competitively. In addition, population shifts to the Sun Belt have increased the local markets for Florida, Texas, and Arizona growers.

Higher labor costs also put California growers at a comparative disadvantage. Wage rates for California farm workers average above those for Florida, Texas, and other vegetable-producing states. Higher wage rates are closely related to the higher cost of living in California. Because labor costs account for roughly 50 percent of the cost of producing a box of lettuce, lettuce producers in California are at a disadvantage.

Processing Tomatoes

Tomato producers in California will continue to experience disappointingly low prices and narrow margins in 1984. Late in 1983, price expectations were quite high. Because cotton and other field crop prices were high, tomato growers reasoned that 1984 prices for their product would have to be well above 1983 levels to induce growers to plant enough acres for processors' demands in 1984. However, during early 1984, import competition and lower expectation for 1984 field crop prices depressed the price outlook for tomatoes.

Growers chose to grow tomatoes over other field crops when field crop prices declined. In addition, canners faced sales difficulties due to imports from Italy, Spain, Portugal, and Israel. These factors have forced the price to the growers in 1984 to be nearly unchanged from the 1983 price.

With a modest increase in operating expenses, growers will experience narrowing margins this year. These thinner margins are of special concern to tomato growers in the Sacramento River Delta region because their per-ton costs of production are higher than for growers in the southern and central San Joaquin Valley. Growers in the south can generally make a reasonable return even at current prices while growers to the north will experience tight margins.

Livestock and Livestock Products	Percent Change	Total Receipts	Percent Change
(millions)		(millions)	
$3,402	14.1	$10,575	12.0
4,227	24.3	12,932	22.3
4,089	-3.3	14,002	8.3
4,227	3.4	14,048	3.3
4,381	3.6	14,379	2.4
4,300	-1.8	13,607	-5.4
4,470	4.0	14,760	8.5

Expanded Cash Receipts for Fruits and Nuts

Cash receipts from fruits and nuts will expand 10 percent to $2.9 billion dollars in 1984, following a decline of $400 million in 1983. Sales will increase as world economic recovery boosts demand for these products. However, cash receipts will remain below the record 1980 level of over $3 billion. A continued strong dollar and trade friction with the European Economic Community have limited export expansion.

Overall, margins will improve for growers in 1984. However, a substantial portion of fruit and nut producers who are heavily in debt or producing a commodity with weak sales growth, such as raisins, will suffer continued cash flow difficulties.

Almonds

Almond growers will experience a turnaround year in 1984. Sales are expanding, prices are improving, and profits are returning to producers. A short crop in 1983, caused by severe winter weather, reduced the surplus that had depressed the market in the early 1980s. Expanding domestic and world economies will boost nut sales in 1984. Per capita consumption in the United States has increased 40 percent since 1980. In addition, export sales are increasing.

The U.S. dollar has declined 10 percent in relation to the German mark during the last few months. Lower almond prices in terms of the mark will expand sales to West Germany, the largest foreign purchaser of California almonds. In addition, Spain, the only other major almond-producing region in the world, suffered a freeze early this

THE EEC AND CALIFORNIA AGRICULTURE

The European Economic Community (EEC), consisting of 10 European nations* plays an important role in the economic well-being of California agriculture. As a group, the 10 nations provided the largest market for the state's agricultural products outside of the United States, paying California farmers nearly $1.0 billion for their products in 1983. Conversely, exports of European farm commodities offer keen competition for leading California products in the United States markets.

In recent years the EEC's Common Agriculture Policy (CAP) has become the focus of attention for California farmers as exports to the EEC have dropped off dramatically while the EEC's share of the U.S. wine and canning tomato markets has increased.

Different Approaches to Farm Policy

Although the United States and the EEC spend roughly the same amount of money on farm programs and subsidies, their policies are fundamentally different. In general, the objective of U.S. farm policy is to maintain domestic commodity prices relatively close to world prices and support farm incomes by making direct payments to growers. If surpluses develop, causing prices to fall in the United States, programs are enacted to cut production in order to return balance to supply and demand.

On the other hand, the objective of the EEC farm policy is to keep domestic prices high. In addition, by creating a system of trade barriers, imports into the EEC of agricultural goods that are also produced there, such as wine, are severely limited. If surpluses develop, rather than cut production, the EEC pushes export prices artifically low in order to sell these surpluses in the world market. Essentially, the EEC exports its farm surplus problems to other agricultural regions of the world.

EEC policies generally have had a greater impact on California agriculture than on U.S. agriculture as a whole. Europe produces many of the same fruits, nuts, and vegetables that are grown in California. However, the Europeans have chosen to subsidize growers of these crops while the U.S. farm programs have been directed almost entirely to dairy and field crops. Federal marketing orders have played a large role in helping to keep California fruit and vegetable growers incomes steady but do not involve subsidy payments.

Strong Dollar Hurts Exports

In addition to EEC agricultural policies, the rise in the value of the U.S. dollar relative to foreign currencies has hurt California farm products exports and increased competition for the domestic market. The largest export market for California almonds, for example, is West Germany, with Spanish almonds being California's top competition. Although Spain is not yet a part of the EEC, the rise in the value of the dollar in relation to the peseta has cut California market share in West Germany. In 1980, a West German mark would buy 55 cents of California almonds and 33 pesetas worth of Spanish almonds. By 1983 a mark would buy only 39 cents worth of California almonds, but 56 pesetas worth of Spanish almonds. The changing value of the dollar makes it difficult to assess the impact of EEC policies on California distinct from the impact of the dollar.

Nevertheless, plentiful documentation is available which demonstrates the effect of EEC policies on California agriculture, especially the state's wine and tomato industries. Trade groups representing both these industries have proposed legislation to attempt to deal with EEC policies in the U.S. Congress. The Wine Equity Act which promotes equitable wine trade barriers between the United States and Europe is the most publicized, but not the only proposed legislation. However, any proposed legislation to deal with EEC policies faces difficulty in Washington.

The administration promotes free trade, especially in agriculture where the country is a net exporter. In addition, many agricultural interests outside California see legislation such as the Wine Equity Act as a threat to their exports of grain and grain products to Europe. They fear that if the EEC chooses to lower tariffs on wine imports due to the Wine Equity Act, then, as a reprisal, the EEC will also raise the import tariffs on products such as corn and wheat.

Prospects for Improved Trade

The outlook for relief from the adverse effects of EEC agricultural policies through U.S. legislation does not look promising. In addition, Spain and Portugal are designated to become members in the EEC later this decade. At that time, producers of agricultural products in those countries will come fully under the CAP agricultural-subsidy umbrella. Some preferential treatment to those countries is already being given by the EEC in anticipation of their entrance into the Community. Spanish membership alone would raise EEC wine production by 48 percent and carrot production by 25 percent. Since these two countries produce many crops grown in California, and compete with California for markets in current member countries, their entry into the EEC can be expected to severely limit California exports to Europe.

Nevertheless, the potential exists for improved trade relations with the EEC in the coming decade. Just as U.S. citizens have criticized the U.S. dairy program spending, citizens of the EEC are revolting against the high price of agricultural subsidies. If unchecked, total EEC spending will surpass the annual EEC budget ceiling in 1984. As agricultural spending accounts for roughly 60 percent of total EEC spending, cuts in farm supports are likely.

Some reductions in EEC commodity and dairy subsidy programs were recently achieved. These cuts demonstrated a dramatic change in direction for the EEC and will likely be followed by further cuts. In addition, any relief from a weakening dollar in the coming year will benefit California farms. Overall, the peak has likely been reached in trade friction with the EEC. However, relief from competition will be gradual, with only slow growth in exports to Europe and continued competition for U.S. markets from European producers likely in the coming years.

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* Belgium, Denmark, France, Greece, Ireland, Italy, Luxembourg, The Netherlands, The United Kingdom, and West Germany.

year. With a short Spanish crop, export sales for California almonds will be boosted.

Overall, prices are expected to increase substantially in 1984 to profitable levels for most producers. However, even at $1.20 per pound this year prices would still be well below the $1.50 per pound levels experienced in the late 1970s. Even though growers would like prices to reach those high levels, such a high price would encourage more planting.

Currently there are 38,000 acres of nonbearing almond trees in the state and 350,000 bearing acres. Strong marketing efforts by California almond growers will be necessary just to market the increase in almond production expected when these nonbearing acres come into production. Fortunately, if current prices continue, growers will make profits, but extensive new plantings will not be encouraged.

Grapes

Although grapes, like almonds, have experienced reduced total inventories and expanding markets this year, the overall financial condition of many growers is still poor. Wine inventories at the end of 1983 were down 8 percent from 1982 levels. Raisin inventories, however, grew in 1983 even as inventories of wine declined. This was due, in part, to Thompson Seedless grape growers switching a portion of their crop from wine production in 1982 to raisin production in 1983. This switch, plus adverse weather, decreased the 1983 wine crush to 2.2 million tons, down 30 percent from the record 1982 crush. Only 14 percent of the Thompson Seedless harvest was crushed for wine, down from an average of 40 percent during the last 20 years.

A large supply of Thompson Seedless grapes is likely to keep inventories high and prices low in both the raisin and wine markets in the coming year. Unless the weather greatly reduces the 1984 crop, a tremendous surplus of raisins will continue to exist in the state. Prices for raisins could continue to be below $700 per ton.

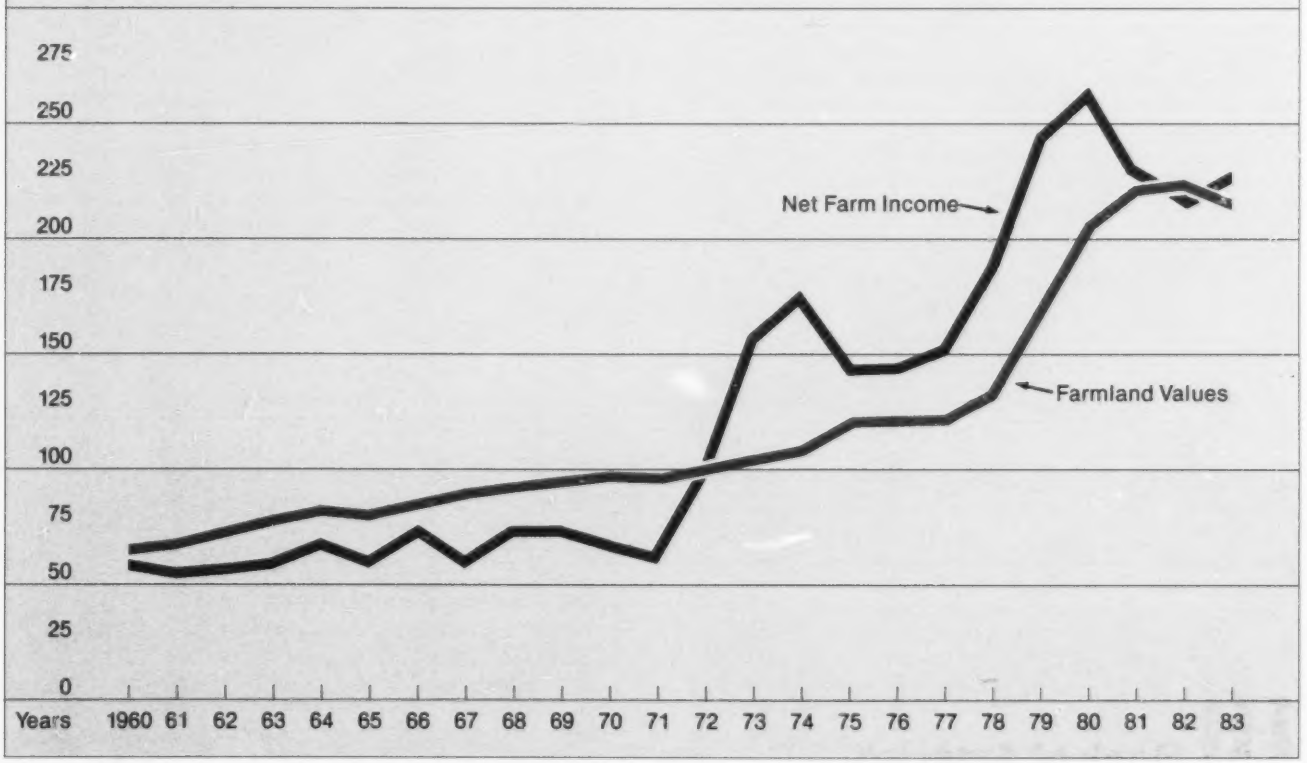
Growers of varietal wine grapes will increase their markets as wine sales improve with the general economy. However, growers of grapes that can be partially substituted by Thompson Seedless grapes, such as Chenin Blanc, may have their price improvement limited by low prices for Thompson Seedless grapes. Thompson growers, facing low prices if they choose to produce raisins, may try to sell the grapes to wineries. These sales would, however, create excess wine inventories and low wine prices.

CONCLUSION: A DIFFERENT DECADE

Characterized by falling commodity prices, declining farmland values and growing debt, the 1980s have thus far proved to be a difficult decade for California farmers. The decline in both the value and earning power of farm assets has been a dramatic turnaround from the farm boom of the 1970s (see Figure 2).

Although improvement in the financial strength of California agriculture during the remainder of the decade is expected, a return to the net-income growth and farm-asset appreciation of the 1970s is not likely to occur. Such long-term cycles are nothing new to farming. Both 1910-1920 and 1940-1950 were rapid growth decades for agriculture and

Figure 2. Indexes of California Net Farm Income and Average California Farmland Values, 1960–1983 (1972 = 100)



both were followed by two decades of slow growth.

Fundamentally, agriculture thus far in the 1980s can be characterized as being different than the 1970s in four ways:

- Inflation and commodity prices have declined significantly. From 1981 to 1983 the Consumer Price Index in the United States climbed 17 percent compared to an increase of 31 percent in the three-year period from 1977 to 1979. While this decline in the inflation rate allowed production cost increases to subside, it also is correlated with a much more dramatic drop in agricultural commodity prices. Between 1972 and 1980 the Bank of America Agricultural Commodity Index increased 227 percent; since 1980 the index has declined 27 percent. In addition, low rates of inflation reduce the incentive for investors to buy farmland, which had been considered a hedge against inflation. This has weakened the demand for and price of agriculture lands.
- Exports, which were the growth market for farm goods in the 1970s, have dropped off in the 1980s as a result of world recession and the growing value of the dollar in relation to foreign currencies. In 1982, California farm exports declined 21 percent and in 1983 preliminary figures indicate a drop of more than 5 percent. Although modest growth in exports is expected for the remainder of the decade, export growth of 42 percent experienced in 1980 is not likely to be repeated.
- Interest rates have risen dramatically in relation to inflation. During the 1970s the inflation rate and interest rates on average were nearly equal. During that time, it was natural for farmers to borrow to expand operations since higher commodity prices would ensure that payments could be made. Now, with interest rates high, and inflation and commodity prices low, many growers are having difficulty repaying their debts.
- Farmland values have declined in the 1980s following the rapid rise of the 1970s. Farmers found their asset value being eroded at the same time commodity prices declined. During the 1970s, if a grower experienced a bad year, borrowing money against the capital gains achieved in land appreciation was possible. With declining or stagnant land values this method of financing is no longer available.

These four major changes have resulted in a decline in the strength of the farm sector's balance sheet. Nationwide, the debt-to-asset ratio of farms increased from 17 percent in 1980 to 21.4 percent in 1983. California has had a similar experience as debt has increased, as growers have had to borrow to continue operations, and farmland values have weakened. Furthermore, a return to the rapid growth in net farm income and farmland values during the remainder of the 1970s cannot be expected. Therefore, in order to survive during the 1980s, agricultural operations must make major adjustments to deal with these fundamental changes.

Three areas where producers can make changes in order to survive during the 1980s are:

Debt Management—With interest rates well above the rate of inflation, farm debt must be kept under control. Reduction of principal, not extension of debt, should be a goal of farms whenever possible. Growers should keep good records and projections of cash flow in order to make debt-reduction decisions on reality and not perceptions. Good records and communication with officers of lending institutions also will allow producers to know early when debt levels are getting out of control. Early remedies can help avert future problems. Cropping patterns can be switched to lower risk and less capital intensive crops. For example, some farmers will find it prudent to plant wheat at a cost of $250 per acre rather than cotton at a cost of $800 per acre. With farming costs minimized, indebtedness can be reduced and the long-run financial strength of farm operations will improve.

Risk Management—With commodity prices low, debt levels high, and profit margins narrow, farmers do not have as great an ability to survive a short crop or a rapid price decline as they have in the past. Therefore, whenever possible, large risks should be averted. Federal crop insurance programs should be explored. For field-crop farmers not affected by the $50,000 payment limitation, enrollment in federal farm programs should be continued. Forward contracting of crops when prices reach profitable levels should be completed, rather than waiting for the highest possible price and risking a loss. Diversification of crops also reduces risk.

Operating Efficiently—Especially during difficult times in farming, the low-cost producers of commodities will outperform high-cost competitors. Modernizing equipment and operations is essential only if the payments on the debt incurred will not offset the lower costs of production. Correct levels of inputs must be discovered that maximize returns, not that merely maximize yields. Growers must also be innovative in their marketing, creating the quality of product which obtains the highest return.

Overall, farms that adapt to the changing agricultural economic environment of the 1980s will survive and grow.

Bank of America, as the nation's largest commercial bank lender to agriculture, provides a complete package of financial services to farmers and other agribusiness participants. These services include the financing of crop and livestock production, farm real estate and improvements, as well as financing operations of feedlots, co-ops, processors, and dealers. It also provides commodity loans, equipment financing and leasing, trade and margin financing, appraisal, and trust services and farm management. For crop-production loan customers, Bank of America offers a computer-assisted financial service. This service covers all related aspects of financial management and planning for farmers, and allows them to monitor their progress against projections and goals.

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